Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Polanco	Analyst:	Kimberly Pantoja	Bill Number:	SB 2150
Related Bills:	See Legislative History	Telephone:	845-4786	Introduced Date:	02/25/2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Child Care Refundable Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a refundable credit of $350 for each child of the taxpayer for whom at least $2,500 was paid or incurred for child care. The credit would be allowed only if the taxpayer's total household income is below 250% of the poverty level.

EFFECTIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 149 (1999), AB 401 (1999), and AB 1174 (1999) all proposed nonrefundable Child Care Credits. AB 149 was amended to be a Household and Dependent Care Credit, AB 401 remained a Child Care Credit, and AB 1174 was amended to be a Democracy Volunteer Credit. All three bills failed to pass out of the house of origin by the deadline.

SPECIFIC FINDINGS

Existing federal law allows a credit against tax equal to 20% to 30% (depending on the taxpayer's adjusted gross income) of employment-related expenses for the care of a qualifying individual. A qualifying individual is defined as a dependent of the taxpayer who is under the age of 13 or a dependent or spouse who is physically or mentally unable to care for him- or herself. Employment-related expenses are defined, generally, as those expenses incurred to enable gainful employment.

Existing federal law limits the qualifying amount of employment-related expenses incurred during a taxable year to $2,400, if there is one qualifying individual, or $4,800, if there are two or more qualifying individuals with respect to the taxpayer for that taxable year.

Under provisions of federal law (Title IV of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193)), certain aliens are ineligible for federal, state and local public benefits. As a refundable credit, the proposed state Child Care Credit could be considered a public benefit. By its terms, this federal law applies to states.

Board Position:			Department Director	Date
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Prior state law allowed a similar credit based upon expenses for household and dependent care services necessary for gainful employment. That credit was a percentage of the federal credit; the percentage was based upon the taxpayer's adjusted gross income (AGI) and ranged between 15% and 30%. That credit provision was repealed by its own terms December 31, 1993.

Prior state law allowed a $1,000 credit to any qualified parent who filed as a head of household, a surviving spouse, or married filing jointly and claimed a dependent child who had not reached the age of 13 months. The qualified parent (or spouse in the case of a joint return) could not have earned income. The $1,000 was reduced for surviving spouses or married taxpayers if the spouse's income exceeded certain levels. This credit was allowed in 1991, 1992, and 1993.

Existing state law provides various personal credits to taxpayers that may reduce (but not below zero) their state income tax. Existing state law does not provide a Child Care Credit. However, **existing state law** provides two credits relating to children, the joint custody head of household credit and the adoption costs credit.

State law provides a personal exemption credit of $72 for each taxpayer, plus an additional exemption credit for those individuals who are over 65 years of age or are blind, and an exemption credit of $227 for each dependent. These amounts are for 1999 and are increased annually for inflation.

Under **state law,** individuals who make less income than the filing thresholds are not required to file an income tax return since the standard deduction and personal exemption credit would eliminate any tax liability. For 1999, these filing thresholds are $10,899 in gross income or $8,719 in AGI for single taxpayers and $21,798 in gross income or $17,438 in AGI for married filing joint taxpayers. These thresholds are increased based on the number of dependents. These thresholds also are increased annually for inflation.

This bill would allow a refundable credit of $350 for each child of the taxpayer for whom the taxpayer paid or incurred at least $2,500 for child care. The credit would only be allowed if the taxpayer's total household income is below 250% of the poverty level.

This bill specifies any credit in excess of the tax liability shall be credited against other amounts due, and the balance shall be refunded to the taxpayer.

This bill specifies that no deduction would be allowed for the same expenses for which the credit was allowed.

Since **this bill** does not specify otherwise, the existing state law providing general rules regarding the division of credit among taxpayers who share in the expenses would apply.

Policy Considerations

Historically, refundable credits (such as the state renter's credit, the federal Earned Income Credit and the federal credit for gasoline used for farming) have had significant problems with invalid and fraudulent returns.

This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness.

Implementation Considerations

This bill uses the term "child care"; however, this term is not defined in the bill. It is unclear, for example, if "child care" includes expenses, services and/or payments to related individuals. In addition, the child care expenses are not related to the taxpayer's employment. Undefined terms can lead to disputes between taxpayers and the department.

The department's administration of the credit would be simplified if taxpayers were required to keep substantiation for the expenses.

To the extent the Child Care Credit exceeds tax liability and is refunded, it may be interpreted to be a state public benefit under federal law. As a public benefit, the proposed credit falls under the federal provisions making certain aliens ineligible for state public benefits. To establish eligibility, the claimant must declare himself/herself to be a citizen of the United States or an eligible alien. The FTB has no method in place to easily verify eligibility, and the volume of claims anticipated is large.

The bill does not require the credit to be claimed only with respect to the taxpayer's dependent or minor children who reside with the taxpayer. Therefore, it appears that both divorced parents could claim the credit on the same child if each paid sufficient child care expenses. In addition, nothing prevents a taxpayer from claiming the credit for care of an adult child. Clarification is needed if this is not the author's intent.

The proposed credit under this bill would be claimed by low-income taxpayers. Low-income taxpayers generally file their tax returns on forms 540A, 540EZ or 540-2EZ. To minimize the complexity of these returns, credits are not currently allowed on these forms, other than the nonrefundable renters' credit. Adding lines to these forms would increase their complexity and could have a moderate to significant impact on the department's operations.

Tax benefits are generally tied to adjusted gross income (AGI) levels. However, this bill would limit the credit to taxpayers with total household incomes below 250% of the federal poverty level. According to the 1999 U.S. Department of Health and Human Services Federal Poverty Guidelines, the poverty guidelines are sometimes loosely referred to as the "federal poverty level" (FPL), but that term is ambiguous and should be avoided in situations (e.g., legislative or administrative) where precision is important. There are no universal administrative definitions of "family," "family unit," or "household" that are valid for all programs that use the poverty guidelines. The absence of a definition that identifies the author's intent complicates the administration of this credit.

The 1999 U.S. Department of Health and Human Services Poverty Guidelines indicate the following (not including Alaska and Hawaii):

Size of Family Unit	48 Contiguous States and D.C.	x250%
1	$8,240	$20,600
2	11,060	27,650
3	13,880	34,700
4	16,700	41,750
5	19,520	48,800

For each additional person add $2,820.

Since the “federal poverty level” generally refers to more than an individual, it is unclear how the department would determine eligibility for the credit. For example, it is unclear how the income of the other individuals within the household would affect the taxpayer's eligibility for the credit. Each member of the household might be required to disclose personal information regarding second employment, spouse's income, family or household income, and possibly family size.

The department has no ability to verify household or family income. Tax benefits, such as the renters credit, generally are tied to an AGI amount, with a maximum AGI for qualifying married couples filing a joint return and heads of household and a lower maximum AGI for qualifying single filers.

Finally, the time period for computing the household income limitation is not specified. The bill should provide that it is the total household income "for the taxable year" to make it clear that the year in which the child care expenses are paid or incurred is the same year that the household income limitations are calculated.

FISCAL IMPACT

Departmental Costs

First year implementation costs are estimated at $2.1 million and ongoing costs are estimated at $1.3 million per year. This estimate does not consider satisfying the federal law concerning eligibility of certain aliens for state public benefits.

The estimated costs are based on the processing of an estimated 671,000 claimants. Other costs include changes to the computer systems that currently do not contain logic to process a refundable credit, changes to existing tax forms, increased taxpayer phone calls and correspondence, and electronic and paper storage.

Tax Revenue Estimate

Revenue losses under the PITL are estimated to be:

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 1999 Enactment Assumed After June 30, 2000 $ **Millions**		
2000-01	2001-02	2002-03
-$69	-$72	-$76

Note: It was assumed for this analysis that only expenses qualifying for the federal child care credit would be "qualified child care" expenses for this bill and that any taxpayer with total household income of $41,750 and less would qualify for the tax credit. This income level was based on the federal poverty level for a family of two adults and two children ($16,700 x 250%). Under current law and tax rates a married couple filing joint with two dependents would have a $0 tax liability, therefore, all of the credits would be refunded to taxpayers.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Revenue losses under the PITL would depend on the number of taxpayers who would incur at least $2,500 for child care and meet the income level as stated above.

The above estimates were based on simulations using the department's personal income tax model. Special programming was done to reflect the federal poverty level and eligible child care expenses.

BOARD POSITION

Pending.